

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
INTERNATIONAL BUSINESS)
MACHINES CORPORATION)

For Appellant: F. L. Bruno
Manager of State Tax Planning

For Respondent: Bruce W. Walker
Chief Counsel

Kendall E. Kinyon
Counsel

O P I N I O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of International Business Machines Corporation against a proposed assessment of an estimated tax underpayment penalty in the amount of **\$34,142.97** for the income year 1974.

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The sole issue for determination is whether a penalty for underpayment of estimated tax for the income year 1974 was properly assessed.

Appellant, a New York corporation, commenced doing business in California in 1933. It is an accrual basis taxpayer and files its franchise tax returns on a calendar year basis.

During 1974 appellant made the following estimated tax payments:

<u>Payment</u>	<u>Date</u>	<u>Amount</u>	<u>Total</u>
1st Installment	4-10-74	\$2,780,000	\$ 2,780,000
2nd Installment	6-14-74	2,780,000	5,560,000
3rd Installment	9-15-74	3,901,000	9,461,000
4th Installment	12-13-74	2,862,000	12,323,000

Appellant requested and was granted an extension of time until September 15, 1975, to file its 1974 return. With its extension request appellant paid \$1,811,000.00. Appellant's return for income year 1974 reflected a liability of \$16,505,362.79. Payment of the balance due, \$2,371,362.79, plus interest, accompanied the return.

Respondent determined that appellant **was** subject to a penalty of \$34,142.97 for underpayment of its first and second installments of estimated tax. Accordingly, a notice of proposed assessment was issued. Appellant's protest was denied and this appeal followed.

Every corporation subject to the franchise tax is required to file a declaration of estimated tax and pay the estimated tax during the income year. (See Rev. & Tax. Code, §§ 25561-25565.) If the amount of estimated tax exceeds \$200.00, it is payable in four equal installments. (Rev. & Tax. Code, § 25563, subd. (d).) A penalty is imposed on corporations which underpay their estimated tax by section 25951, which provided:

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In case of any underpayment of estimated tax, except as provided in Section-25954, there shall be added to the tax for the taxable year an amount determined at the rate of 6 percent per annum upon the amount of underpayment (determined under Section 25952) for the period of the underpayment (determined under Section 25953).

The "amount of underpayment" is defined as the excess of the amount of estimated tax that would be required to be paid on each installment if the estimated tax were equal to 80 percent of the tax shown on the return for the income year over the amount actually paid on or before the due date of each installment. (Rev. & Tax. Code, § 25952.)

The tax liability reflected on appellant's return for the 1974 income year was \$16,505,362.79. Accordingly, appellant was required to estimate and prepay at least 80 percent of \$16,505,362.79 in four equal installments of \$3,301,072.56 on April 15, June 15, September 15, and December 15, 1974. Since the April 15 and June 15 payments were only \$2,780,000.00, appellant is subject to the estimated tax underpayment penalty imposed by section 25951 unless it qualifies for relief under section 25954. For purposes of this appeal section 25954 provides that the penalty shall not be imposed if the total amount of estimated tax payments made by each installment due date equals or exceeds the amount that would have been due by such date if the estimated tax were the lesser of: (a) the tax shown on the taxpayer's return for the preceding income year; or (b) an amount equal to 80 percent of the tax for the taxable year computed by placing on an annualized basis the taxable income for stated periods of the income year preceding each estimated tax installment due date.

It is appellant's position that, essentially, it has complied with both of the exceptions contained in section 25954 set out in the previous paragraph.

First, appellant argues that it should be granted relief pursuant to subdivision (a) of section 25954 which allows a taxpayer to calculate its quarterly installments based upon the prior year's tax. Appellant filed its previous year's return, its 1973 return, on September 13, 1974 after receiving an extension of time. The 1973 return reflected a tax liability of \$12,322,038.46. Based upon its 1973 tax liability, the amount of estimated tax

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required to be paid by April 15, 1974 was 25 percent of the total liability, or \$3,080,509.61. The cumulative amount of estimated tax required to be paid by June 15, 1974 was- 50 percent of the 1973 tax liability, or \$6,161,019.23. The cumulative **amount of** estimated tax actually paid by appellant by April 15 and June 15, 1974 was \$2,780,000.00 and \$5,560,000.00, respectively. However, since the first two 1974 installment payments were due before the 1973 return was filed, appellant contends that the only available information that could be used to determine those payments was the final 1972 tax of \$10,171,517.00. Had appellant based its first two installments of estimated tax on the amount: of tax shown on its 1972 return, it would have been required to pay only \$2,542,879.00 which was less than the \$2,780,000.00 which it actually paid. Thus, appellant concludes that it has complied with subdivision (a) of section 25954 since the 1972 return was the latest return filed at the time the first two installment payments were due.

Although appellant's argument in this respect is ingenious, we do not find it persuasive. Section 25954 speaks in terms of the taxpayer's return "for the ~~income~~ **year**." We believe that in selecting the adjective **preceding** the Legislature had in mind the year immediately prior to the year in question and not another year more remote in time. Therefore, the reference year in this appeal is 1973 and not 1972 as contended by appellant. Since, for whatever reason, appellant did not measure its estimated tax payments by the tax as shown on its 1973 return we cannot conclude that it qualifies for relief under subdivision (a) of section 25954.

Next, appellant argues that it has essentially complied with subdivision (c)(2) of section 25954 which permits a **taxpayer** to use an annualized income formula to compute its installment payments. Appellant states that it **consistently** pays the April 15 and June 15 installment payments based on its estimated federal income as adjusted for purposes of the California combined report. As soon as the previous year's tax return is filed, the third and fourth installments are determined and paid in two equal payments which total the lesser of: the difference between the tax shown on the previous year's 'return less the first two installments; or the revised **estimate** of federal tax liability, as adjusted. In accordance with this method, appellant maintains that by December 15 it has paid an amount equal to the previous year's total California tax, and, essentially, has **complied** with the annualization exception.

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We cannot agree. The annualized income formula contained in subdivision (c) of section 25954 is quite specific and does not comport with the method described by appellant.



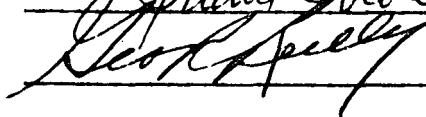
While we are not unsympathetic to the difficulties encountered by appellant in attempting to comply with the intricacies of California's estimated tax payment scheme, we must apply the law as it exists. The only exceptions to the operation of the estimated tax penalty provisions are contained in section 25954. Relief from the penalty for underpayment of estimated tax is not available upon a showing of reasonable cause, lack of willful neglect, or extenuating circumstances. (See, e. g., Appeal of J. F. Shea Co., Inc., decided this date; Appeal of Lumbermans Mortgage Co., Cal. St. Bd. of Equal., Dec. 15, 1976; Appeal of Decoa, Inc., Cal St. Bd. of Equal., April 5, 1976.) Accordingly, respondent's action in this matter must be sustained.

O R D E R

Pursuant to the views expressed in the opinion of the board on **file in this proceeding, and good cause appearing** therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of International Business Machines Corporation against a proposed assessment of an estimated tax underpayment penalty in the amount of \$34,142.97 for the income year 1974, be and the same is hereby sustained.

Done at Sacramento, California, this 16th day of August, 1979, by the State Board of Equalization.

 , Chairman
 , Member
 , Member
_____, Member
_____, Member